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E. ROBERT SEAVER,

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 61

INVESTMENT COMPANY INSTITUTE, *et al.*,

Petitioners,

v.

WILLIAM B. CAMP, Comptroller of the Currency;
FIRST NATIONAL CITY BANK,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR PETITIONERS

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November 20, 1970

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REPLY BRIEF FOR PETITIONERS

I.

The issue is whether the Comptroller may authorize the Citibank type of investment fund—not whether he may authorize banks to commingle assets held in managing agency accounts.

Respondents do not dispute that a mutual fund is engaged in the business of issuing and selling securities within the meaning of the Glass-Steagall Act (Citibank Br. 46, 57).[1] Nor do they dispute that Section 21 of the Act (12 U.S.C. § 378) therefore prohibits banks from engaging in the mutual fund business just as it prohibits mutual funds

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[1] Citations to the Comptroller's brief are herein referred to as "Compt. Br.," to Citibank's brief as "Citibank Br.," and to petitioners' principal brief as "Pet. Br."

from engaging in the banking business. Respondents concede, moreover, the "competition" and "points of similarity" between Citibank's "Commingled Investment Account" and at least "no load" mutual funds (Citibank Br. 12).

Respondents claim, however, that the Act still does not apply to the Citibank type of fund which now stands as the prototype for bank-sponsored investment funds (A. 94). They pretend that the Comptroller's approval of such funds simply permits banks to pool managing agency accounts in the same manner as they have for many years pooled trust assets in common trust funds. Three related points expose the fiction:

1. Banks have been prohibited from holding out common trust funds to the public as investment media on the ground that such activity would constitute selling interests to the public in investment funds. Banks have been permitted to commingle trust assets solely to aid administration of the underlying trusts. Under such permissible type of commingling, trust officers exercise discretion, based on their judgment of the particular beneficiaries' requirements, to invest various assets from time to time in the bank's common fund. See pp. 6-10, 12-13, *infra*.

2. The original concept of Regulation 9 was to extend a like authority, with like restrictions, to the commingling of assets held in managing agency accounts, again as determined by individual trust officers in accordance with the particular needs of each customer. The Comptroller's 1963 Annual Report to Congress represented that the restrictions of Regulation 9 were designed to make certain that banks could not

> "engage in the selling of interests in pooled funds. Accordingly, there may be no agreement between the bank and the customer that the latter's funds will be

invested in collective investment funds, nor may managing agency contracts be operated or held out as interests in a collective investment fund." H.R. Doc. No. 317, 88th Cong., 2d Sess. 14 (1963).

In 1965, however, Comptroller James J. Saxon abandoned these restrictions when he approved the Citibank fund (see pp. 11-12, *infra*), and announced that all similar funds would also be approved (A. 94, 205).

3. The Citibank prototype plan permits the very sale of interests in a pooled fund that the Comptroller had told Congress Regulation 9 was designed to prohibit. The plan does not contemplate that bank trust officers will exercise discretion whether or not assets held in particular "managing agency" accounts should be invested in a commingled fund. Indeed, the bank may know no more about its customer than his name, address and social security number. See note 5, *infra*. The customer's money is accepted solely for direct and automatic investment in the commingled fund. The customer's relation with the bank begins with investment of his money in the pooled fund and terminates upon withdrawal of his share from the pooled fund (which the customer can effect at any time) (A. 147, 148, 150-51, 158, 197-98, 201-03). The fund itself is held out to the public as an investment medium (A. 170; see also Appendix B to this brief). The "managing agency" form contracts (A. 158-59) are merely the legal device by which the public is sold interests in the pooled fund.

The Citibank "Commingled Investment Account" is thus a far cry from both the common trust fund and the Comptroller's original concept of Regulation 9, under which he was to impose restrictions upon the commingling of managing agency accounts similar to those which had long

applied to common trust funds. See pp. 10-12, *infra*. Accordingly, respondents' central argument that the commingling of managing agency accounts is essentially the same as the pooling of assets in a common trust fund (Compt. Br. 39-40; Citibank Br. 22, 25, 31-32, 39) is beside the point. The issue is whether the Comptroller had authority to approve Citibank's prototype fund, not whether the Comptroller could have authorized commingling of managing agency accounts under restrictions not here applicable.

II.

The Citibank type of fund necessarily involves the issuance and sale of securities within the meaning of the Glass-Steagall Act.

Petitioners contend that a bank which operates a fund like that of Citibank is engaged in the business of issuing and selling securities within the meaning of the Glass-Steagall Act for the same reasons that a mutual fund has been held to be engaged in the business of issuing and selling securities within the meaning of that Act. See pp. 20-22, 27-28, *infra*. In both cases, the securities—by whatever name called—are the ownership interests in the fund.

Respondents incorrectly attribute to petitioners a "contention that the term 'securities' has the same meaning in Glass-Steagall as in the federal securities laws" (Compt. Br. 37; see also Citibank Br. 53-54). Petitioners do not so contend. Petitioners rely instead on the substance and reality of Citibank's fund, just as the Federal Reserve did in concluding that the "units of participation" in Citibank's fund are "securities" *within the meaning of the Glass-*

Steagall Act[2] (a fact which neither respondent mentions).[3] The SEC likewise relied on the economic realities in concluding that Citibank's fund and the ownership interests in it required registration under the Securities and Investment Company Acts.[4] Petitioners contend that Citibank is operating a mutual fund and is engaged in the business of issuing and selling securities within *any* rational definition of those terms.

Respondents do not dispute that the sale of shares in an open-end investment fund ordinarily constitutes an engagement in securities activities within the meaning of the Glass-Steagall Act (Citibank Br. 46). Nor do we understand

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[2] The Federal Reserve's Memorandum of December 15, 1965, stated:

"PARTICIPATIONS WOULD BE 'SECURITIES'

"Counsel for First [Citibank] urged that the participations or interests in Account would not be 'stocks, bonds, or other similar securities,' within the meaning of section 32 [of the Glass-Steagall Act]. . . .

"The Board, however, has consistently taken the position that participations or shares in an ordinary open-end investment company or mutual fund are 'securities' for the purposes of section 32. (See, for example, 12 CFR 218.101, 1951 Federal Reserve Bulletin 645.) The Board also has expressed the view that 'participating units', which were essentially partnership shares, were 'securities' within the meaning of section 32. The principle applied by the Board was that the statute was sufficiently broad to comprehend securities which, while neither stocks or bonds, have attributes which cause them to be 'similar' to, or somewhat like, either bonds or stock." Reprinted in *Hearings on S. 2704 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 583-84 (1966).

[3] Yet respondents rely on other portions of the same Federal Reserve decision (Citibank Br. 5, 16, 27, 35-36, 44, 59, 62; Compt. Br. 45 n.37).

[4] 15 U.S.C. §§ 77a *et seq.*; 15 U.S.C. §§ 80a-1 *et seq.* See *Hearing on Common Trust Funds Before Subcomm. of House Comm. on Government Operations*, 88th Cong., 1st Sess. 136-37 (1963).

them to dispute that banks are thereby barred from sponsoring garden-variety mutual funds. Their argument that banks may operate the Citibank type of fund rests on three untenable propositions:

(i) The Citibank type of fund is only a "modest extension" of the common trust fund (Citibank Br. 35);

(ii) There are, on the other hand, fundamental differences between Citibank's mutual fund and ordinary mutual funds; and

(iii) The Glass-Steagall Act exempts from its coverage securities activities conducted by banks in a "fiduciary" capacity.

A. *The Sale of Ownership Interests in a Citibank Type of Fund Cannot Be Equated With the Lawful Operation of a Common Trust Fund.*

Respondents contend that:

> "For more than three decades [national banks] have been reducing the cost and thus extending the availability of trust service by commingling the assets of separate trusts in common trust funds for collective investment. *The sole function of Regulation 9.18 and the Citibank plan is to permit the same commingling and reduction of costs in the case of managing-agencies*" (Citibank Br. 20 (emphasis added); see also Compt. Br. 39-40).

The history of common trust funds proves that the Citibank plan by no means involves the "same commingling" as had been permitted in the case of common trust funds. Indeed, banks have since the 1930s been prohibited from using a common trust fund in the manner in which Citibank uses its pooled fund. Under the Citibank type of plan, investors—of whom the bank may know nothing more than their name,

address and social security number[5]—are induced to place their money with the bank for direct investment in a collective fund. The American Bankers Association and the Federal Reserve Board have uniformly condemned all such arrangements in the case of common trust funds.

1. Banks have been prohibited from using common trust funds as investment media.

The American Bankers Association has for years told its members that a common trust fund can only be used as "a tool or method for handling accounts both on the books now and to come on the books in the natural course of business" and that a bank may not

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[5] Under the Citibank plan approved by the Comptroller, the bank may not even be in a position to make the kind of determination as to the suitability of the fund as an investment for a particular customer that a broker or dealer must make in selling mutual fund shares. See SEC Exchange Act Rule 15b10-3, 17 C.F.R. § 240.15b10-3 (1967); *Gerald M. Greenberg*, Exchange Act Release No. 34-6320 (July 21, 1960), at 6. Under Citibank's plan, it is not only possible, but probable, that people who are virtual strangers to Citibank's trust department will become investors in its fund. Thus, one of the millions of people who are customers of the bank may receive a copy of Citibank's sales flyer through the mail (A. 170, 42, 275 n.9; Pet. Br. 41). A customer or visitor at any of Citibank's branches may also learn of the fund through sales literature at the counter (a copy is attached as Appendix B to this brief) which in turn encourages the visitor to ask for a free prospectus. (An earlier version of the prospectus is in the record, A. 146-60.) Citibank now has 2 million retail customers and 190 branches. INVESTORS' READER, Oct. 7, 1970, at 15; see also Pet. Br. 41. A member of the public may also learn of the availability of such literature through Citibank's advertisements. See pp. 16-17, *infra;* see also 12 C.F.R. § 9.18(b)(5)(iv) (1963, as amended). Any of these potential investors may join the fund by tendering his money by mail along with the tear-out authorization form which accompanies the sales literature. *The only information about the customer on the form is the customer's name, address and social security number* (A. 158). In the face of these facts, and despite Judge Bazelon's dismissal of their contention in this regard (A. 275 n.9), both respondents still find it necessary to advance their

> "operate a common trust fund so as to compete with savings departments or investment trusts, merely to swell the volume of its trust assets through the attraction of money seeking investment alone." Trust Division, American Bankers Association, *Common Trust Funds* 16 (2d ed. 1948); see also *id.* 17, 22-23.

The current version of *Common Trust Funds* (3d ed. 1956) states:

> "The corporate trustee . . . must restrict its trust new business efforts, insofar as accounts to participate in its common trust fund are concerned, to accounts definitely having a fiduciary character, *and must never regard itself in this capacity as a competitor of exclusively investment media.*" *Id.* at 19-20 (emphasis added); see also *id.* at 22.*

These conclusions of bank trust officials reflect the views of the Federal Reserve Board in promulgating and in

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discredited claim that "if the Bank is satisfied that the investment policy of the Account is suitable for the individual's needs, it accepts his money . . ." (Compt. Br. 10; see Citibank Br. 11). That is all respondents have to connect Citibank's "Commingled Investment Account" with the personal attention to individual customers' particular needs that has always been the essence of fiduciary services by bank trust departments under 12 U.S.C. § 92a.

* These exhortations have been both well understood and rigorously followed by responsible bankers. Thus, G. C. Barclay, former President of the Trust Division of the American Bankers Association (see 102 TRUSTS AND ESTATES 239, 242 (1963)), asserted that "use of common trust funds for purely investment purposes" creates

> "the danger that a participation in a common trust fund will come to be looked upon as a security available for 'purchase' by any member of the general public without regard for the fiduciary aspects." Barclay, *Collective Investment Under Regulation 9*, 102 TRUSTS AND ESTATES 361 (1963).

See also Bronston, *Bank Collective Investment Funds*, 46 TRUST BULL. 230, 231 (1966); Judd, *Common Trust Funds Today*, 102 TRUSTS AND ESTATES 38, 39 (1963).

interpreting its "Regulation F," the precursor of the Comptroller's Regulation 9.[7]

The Federal Reserve's regulation provided that

> "the operation of such Common Trust Funds as investment trusts for other than strictly fiduciary purposes is hereby prohibited." 2 Fed. Reg. 2976 (1937).

The Board said "that a Common Trust Fund should be used merely to aid in the administration of trusts by a trust institution through the commingled investment of funds of various trusts" (26 FED. RES. BULL. 393 (1940)), and warned that:

> "While the operation of a Common Trust Fund might thus enable a trust institution to accept small trusts which it otherwise would be unwilling to handle, it was contemplated *that trust guise or form should not be used to enable a trust institution to operate a Common Trust Fund as an investment trust attracting money seeking investment alone and to embark upon what would be in effect the sale of participations in a Common Trust Fund to the public as investments.*" *Id.* (emphasis added).

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[7] Regulation F, 2 Fed. Reg. 2976 (1937), was promulgated to establish conditions under which common trust funds would enjoy an income tax exemption. Section 169 of the Revenue Act of 1936 was designed to overcome the ruling in *Brooklyn Trust Co.* v. *Commissioner*, 80 F.2d 865 (2d Cir. 1936), that a common trust fund was a taxable entity. As carried over into Section 584 of the *Internal Revenue Code of 1954*, the statute limits the exemption to common trust funds operated

> "in conformity with the rules and regulations of the Board of Governors of the Federal Reserve System [now of the Comptroller of the Currency]."

The purpose of conferring regulatory approval upon the Federal Reserve was to allay fears that the funds might be "commercialized or used for speculative purposes." HOUSE COMM. ON GOVERNMENT OPERATIONS, COMMON TRUST FUNDS—OVERLAPPING RESPONSIBILITY AND CONFLICT IN REGULATIONS, H. Rep. No. 429, 88th Cong., 1st Sess. 5 (1963). See also the Comptroller's 1963 Annual Report, *supra* pp. 2-3, at 371.

The Federal Reserve later denied an application by a bank for permission to accept the placement of sums in the bank's common trust fund because:

> "The analogy with the purchase of investment trust certificates is apparent; *and the use of a common trust fund for this purpose amounts in substance to the operation of the fund as an ordinary investment trust.*" 33 FED. RES. BULL. 1115 (1947) (emphasis added).[8]

Thus, contrary to respondents' claims (and contrary to the assumption of the court below—see A. 278) the history of common trust funds shows that banks could not lawfully use such funds in the manner and for the purposes contemplated by the Comptroller in approving the Citibank type of fund.[9]

2. The prototype fund approved by the Comptroller is no mere extension of the common trust fund authority to managing agencies.

At the time Regulation 9 was promulgated, the Comptroller indicated that its restrictions would maintain the

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[8] See also 42 FED. RES. BULL. 228 (1956); 41 FED. RES. BULL. 142 (1955).

[9] Citibank's assertion that the "Federal Reserve forbade commingling for a number of years, except in the case of strict trusts, but subsequently changed its position" (Citibank Br. 36) is baseless insofar as it suggests that the Board had switched its position on the propriety of banks using a commingling authority of any kind to sell shares in a bank-sponsored mutual fund to the public. Indeed, shortly before the authority over bank trust activities passed to the Comptroller, the Board was so concerned over the possibility that banks might abuse their commingling authority to sell interests in a pooled fund that it proposed to bar banks from investment of revocable inter vivos trusts in common trust funds. A hearing on the proposed rule was held before the Board on May 22, 1961, but no decision was reached by September 1, 1962. See Barclay, *The Estate Planning Policy Statement*, 99 TRUSTS AND ESTATES 1146, 1148 (1960); Wolfe, *Wider Horizons for Common Trust Funds*, 101 TRUSTS AND ESTATES 1075, 1076 (1962).

above-discussed distinctions between the lawful and unlawful uses of common trust funds. The Comptroller's 1963 Annual Report to Congress stated in pertinent part that:

> "[O]nly monies of agency accounts where the bank has assumed fiduciary duties identical to those of formally designated trustees, executors, administrators or guardians qualify as managing agency accounts. As a further restriction, the agreement establishing such an account must expressly provide that funds of the account are received by the bank in trust before the funds of such accounts may be collectively invested." Comptroller's 1963 Annual Report, *supra* pp. 2-3, at 14.

The Report further stated that although the Regulation did not expressly incorporate the prior requirement limiting the commingling authority to accounts established for "bona fide fiduciary purposes," the regulations imposed restrictions which

> "were designed to make clear that the abandonment of the 'bona fide fiduciary purpose' language was not intended to permit banks to engage in the selling of interests in pooled funds. Accordingly, there may be no agreement between the bank and the customer that the latter's funds will be invested in collective investment funds, nor may managing agency contracts be operated or held out as interests in a collective investment fund." *Id.*

The Comptroller further reported that, in view of these restrictions, "the sale by the bank of interests in a collective investment fund is prohibited." *Id.*

Despite these representations, the Comptroller in fact approved a bank fund which accomplishes the very objectives that he assured Congress his Regulation 9 was designed to prohibit. In contrast with his representation that "there

may be no agreement between the bank and the customer that the latter's funds will be invested in collective investment funds"—so as to prohibit a bank from "selling interests" in its fund—the Comptroller approved arrangements between Citibank and its customers under which the latter's money can *only* be invested in the bank's collective investment fund. (A. 142, 147-48, 150-51, 158, 197-98, 201-03.) Any realistic appraisal of Citibank's managing agency contracts and the prospectus which they incorporate requires the conclusion that they are operated or held out as interests in a collective investment fund (A. 170). The requirement that the customers' money be received in trust was likewise abandoned in the approval of Citibank's fund (A. 158, 201-02; see also Pet. Br. 7-8; Brief for United States as Amicus Curiae at 7 n.4, *National Ass'n of Securities Dealers* v. *S.E.C.*, U.S. Sup. Ct. No. 59, October Term, 1970).

These differences between the Citibank type of fund and what was originally intended in extending the common trust authority to managing agency accounts are reflected in testimony given in 1964 by the American Bankers Association representative in support of proposed legislation to permit banks to commingle managing agency accounts, subject to certain controls:

> "Before there can be a bank collective fund there must first be a number of individual fiduciary accounts, trust or agency with the bank.
>
> "By contrast, a person who buys shares in a mutual fund does so exactly as he buys shares in any other corporation.
>
> "Before any funds can be invested in a bank collective fund two separate decisions must be made inside the bank. The bank really has a double responsibility.

"The first decision is what part, if any, of the funds in the individual account are to be invested through the medium of one or more of the bank's collective funds.[10]

. . .

"It should be noted that the bank when it decides to put all or part of an account into a collective fund, exercises a fiduciary judgment for which it may be called to account in a court of law. There is no comparable responsibility on the mutual fund salesman.

. . .

"This requirement [that the bank exercise a fiduciary judgment] eliminates any possibility of a managing agency contract providing for the direct or automatic investment of a management agency account in a collective fund." *Hearings on H.R. 8499 and H.R. 9410 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce,* 88th Cong., 2d Sess. 87-88 (1964) (emphasis added).

Citibank's "Commingled Investment Account" falls on the mutual fund side of the line on each factor relied upon by the Bankers Association.

There is no requirement that the "managing agency" accounts pre-exist their investment in the commingled fund; under Citibank's plan, a person will secure an interest in the fund simultaneously with the bank's acceptance of his money, exactly as one buys shares in a mutual fund.[11] There is no "first decision" by the bank as to "what

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[10] The Comptroller had announced, soon after Regulation 9 was promulgated, that under its requirements, the "decision to invest funds of a managing agency account in a common trust fund, or in any other investment program, is made by the bank." Gerber, *Current Legal Regulatory Developments,* 1 NATIONAL BANKING REV. 133, 139-40 (1963). See also Gerber, *Current Legal Regulatory Developments,* 1 NATIONAL BANKING REV. 261, 266 (1963).

[11] In contrast, the Comptroller had in 1963 submitted a legal memorandum to Congress in which he asserted that SEC was

part, if any" of the customer's money is to be invested in the commingled fund. It is all invested in the commingled fund, automatically. See p. 12, *supra*. This also serves to emphasize the importance of the last of the above-quoted requirements cited by the Bankers Association—namely, that to preclude a bank from converting the commingling authority into authority to operate a mutual fund, the bank must be prohibited from entering into "a managing agency contract providing for the direct or automatic investment of a management agency account in a collective fund." Under Citibank's plan (in which the "managing agency" form contract incorporates the terms of the prospectus) the customer's money is taken solely for direct and automatic investment in the collective fund. The plan admits of no other possible disposition of the customer's money. See p. 12, *supra*.

In every significant respect, therefore, the Citibank plan contemplates the sale of an interest in a pooled fund; its "Commingled Investment Account" [12] is simply a conventional mutual fund operated by a bank.

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wrong in contending that a managing agency contract involves the sale of "an interest in the pooled fund" because, under Regulation 9 ". . . the investment of monies in a collective fund is but one option available to the bank in executing its investment responsibility. Indeed, a requirement in a managing agency agreement that investment must be made in a collective fund would clearly be improper under Regulation 9 . . . ." Reprinted in Comptroller's 1963 Annual Report, *supra* pp. 2-3, at 373.

[12] Other banks which have active plans to establish similar funds are willing to call a spade a spade. SEC filings disclose application or registration statements for: "First Chicago Growth Fund" and "First Chicago Investment Fund" (First National Bank of Chicago); "Continental Bank Security Fund" and "Continental Bank Growth Fund" (Continental Illinois National Bank); "Northwestern Investment Fund" (Northwestern National Bank of Minneapolis); "Citizen's Investment Fund" (Citizens Bank & Trust Co., Park Ridge, Ill.); "First Minneapolis Growth Invest-

B. *There Are No Substantial Differences Between the Prototype Fund Approved by the Comptroller and an Ordinary Mutual Fund.*

Respondents' claim that Citibank's "Commingled Investment Account" significantly differs from ordinary mutual funds rests mainly on attributing magical qualities to the word "fiduciary." The claim also rests on exaggerating the significance of the controls imposed by Regulation 9. These claims provide no basis for distinguishing Citibank's fund from garden-variety mutual funds.

1. *The relationship between the bank and the customer is no more and no less "fiduciary" than is the relationship between the customer and the sponsor of a conventional mutual fund.* Respondents assert that the relationship between the customer and the bank is that of principal and agent and that "an agent is a fiduciary" (Citibank Br. 21, 29-30). The analysis is not helpful. Since Citibank's plan requires automatic investment of the customer's money into a collective fund, the operation of which is in the bank's complete discretion, familiar characteristics of the usual principal-agent relationship are lacking. Citibank's customer has only a share in the bank's fund rather than title to property turned over to the bank for "management," and he has no control over the manner in which the bank as his "agent" operates the commingled fund. Compare RESTATEMENT (SECOND) OF AGENCY §§ 13, 14 (1957). In fact, the customer has no more control over the bank's portfolio decisions than does the investor in a typical mutual fund.

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ment Fund" and "First Minneapolis Income Investment Fund" (First National Bank of Minneapolis); "First Managed Fund" (First National Bank in Dallas); "The C&S Investment Fund" (Citizens and Southern National Bank); "Security Trust Growth Fund" (Security Trust Co., Rochester, N. Y.); and "Northern Growth Fund" and "Northern Investment Fund" (Northern Trust Company, Chicago).

Respondents also rely on particular obligations imposed upon the bank under Regulation 9 for proof of the bank's "fiduciary" status (Citibank Br. 33). Similar obligations are imposed (and with greater specificity) upon mutual funds and their investment advisors under the Investment Company Act of 1940 (see particularly Sections 9, 10, 12, 17, 21, 30, 31, 32, 36, 37, 15 U.S.C. §§ 80a-9, -10, -12, -17, -21, -31, -32, -33, -37, -38), the Investment Advisors Act of 1940 (see particularly Section 206, 15 U.S.C. § 80b-6), and the SEC's rules thereunder.

Thus, looking past the merely formal designations and legal techniques by which Citibank sells interests in its pooled fund—a "managing agency" agreement, which incorporates the terms of a prospectus (A. 158)—the substance of Citibank's relationship to its customer is exactly the same as that of the ordinary mutual fund to its shareholder. Neither is one whit more or less "fiduciary" than the other.

2. *The limits which Regulation 9 places upon the extent to which Citibank may advertise its fund do not differ significantly from restraints upon mutual fund advertising.* Respondents imply (a) that there are no significant limitations on the rights of ordinary mutual funds to advertise, and (b) that prohibiting the bank's advertising its fund "except in connection with the bank's general fiduciary services" (Citibank Br. 33) precludes aggressive selling messages. Both implications are false. Mutual fund advertising is closely regulated under the Securities Act of 1933, the Investment Company Act of 1940, and the SEC regulations under both statutes.[13] On the other hand, re-

[13] The Securities Act and the rules and regulations thereunder impose serious restrictions on the type of advertising which a mutual fund can use. See Section 2(10), 15 U.S.C. § 77b(10);

quiring Citibank to advertise its fund only in the "context of other fiduciary services of the bank" is not a significant limitation. The attached samples of Citibank's trust department advertising[14] touting their "hard-nosed pros" who help "beat the shrinking dollar through a performance-minded investment program" show that such a limitation does not preclude aggressive merchandising (see Citibank Br. 33).[15]

3. *The fact that the customer pays no sales load is irrelevant.* That is the very definition of a "no load" fund which Citibank concedes is engaged in the securities business within the meaning of the Glass-Steagall Act (Citibank Br. 57).

4. *There are no significant differences between the Bank's fee and the fees paid to investment advisors of ordinary mutual funds.* Respondents state loosely that

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Securities Act Rule 134, 17 C.F.R. § 230.134 (1958). The SEC has made clear that the "tombstone" advertisement permitted by Securities Act Rule 134 is not to include selling literature of any kind, but rather must be limited to a description of the nature of the offering. For example, the SEC has stated that the Rule prohibits the use of photographs, references to the performance of a fund as compared to the Dow Jones averages, and the listing of a fund's portfolio. See Securities Act Release No. 33-4709 (July 14, 1964). In addition, the SEC has adopted a Statement of Policy under the Securities Act of 1933 and Investment Company Act of 1940 which puts stringent restrictions on both advertising and supplemental sales literature. For example, any comparison of the mutual fund with any other security or medium of investment or any popular stock price index must contain numerous qualifications as to why the comparison is fair. See Securities Act Release No. 33-3856 (Oct. 31, 1957); Investment Company Act Release No. 40-2621 (Nov. 5, 1957).

[14] Appendix A to this brief.

[15] See also Heniken, *Television and Radio—Media for Joint Advertising Ventures*, TRUST BULL., Sept. 1962, at 37; Bacheller, *Sales Incentives in Trust Selling*, TRUST BULL., Jan. 1966, at 24, 27.

"under Regulation 9 the bank is compensated only as a fiduciary" and the bank's fees are "subject to the Comptroller's scrutiny" (Citibank Br. 34). The Regulation in fact places no dollar limitation upon the bank's fee but only upon the method by which it is calculated. 12 C.F.R. § 9.18(b)(12) (1963, as amended). As we have previously pointed out (Pet. Br. 13, 42), the traditional level of fees for investment advisory services in the mutual fund industry is the same as or less than Citibank's fee of one-half of 1 percent.[16]

Thus, the argument that banks should be able to enter the mutual fund business on the basis of the distinctions advanced by respondents would lead to the fragmented and contradictory positions that (1) garden-variety mutual funds are subject to the Glass-Steagall Act, while bank mutual funds would be free of those prohibitions—although both represent, in economic reality, identical means by which the public may invest in pools of securities; and (2) no-load mutual funds would be subject to the Act, while their twin, the bank mutual fund would not.

C. *The Glass-Steagall Act Contains No Exemption for the Allegedly "Fiduciary" Securities Activities Involved in This Case*

Respondents' argument is based on two propositions: (1) Section 16 in terms exempts from the prohibitions of

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[16] At least one bank which has an application before the SEC for approval of a bank mutual fund provides for fees in excess of what Citibank's fund and other mutual funds generally charge. "Continental Bank Security Fund" (SEC File 2-36449-1) provides for an annual fee of ½ of 1 percent for investment management, plus 1/10 of 1 percent for custodial services and 2/10 of 1 percent for administrative services.

the Glass-Steagall Act securities activities carried out by a bank's trust department; and (2) the Act should not be held applicable to a mutual fund operated by a bank's trust department because a bank cannot make a speculative profit from such a fund.

1. Respondents assert that the Act explicitly exempts from its prohibitions securities activities by national bank trust departments. They argue that Section 16—in prohibiting bank securities activities "for its own account" while authorizing such activities "for the account of customers"—authorizes banks to buy and sell securities in behalf of their trust department customers.[17]

Respondents miss the point of petitioners' contention. They incorrectly assume that petitioners' argument under the Glass-Steagall Act is based on the bank's *portfolio* activities—*i.e.*, the bank's purchase and sale of common stocks and bonds for the portfolio of the collective fund. Petitioners' contention, however, is that the Citibank type of plan is unlawful because it creates a bank-operated mutual fund in which the bank issues and sells ownership interests to the public. It is the issuance and sale of *those* securities—*i.e.*, the ownership interests in the bank-operated mutual fund[18]—which petitioners contend violates the Glass-Steagall Act. Respondents' argument that Section 16 au-

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[17] The Act says:

"The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not undertake any issue of securities or stock . . . ." Section 16, 12 U.S.C. § 24.

[18] As we have noted (pp. 4-5, *supra*), the Federal Reserve held that the ownership interests in Citibank fund—the so-called "units of participation"—are securities within the meaning of the Glass-Steagall Act.

thorizes the bank to buy and sell stocks and bonds for the fund's portfolio is thus beside the point.[19]

2. Respondents also argue that, even acknowledging (albeit grudgingly) that Citibank may be operating a mutual fund (Citibank Br. 12), the Act should still not apply because Citibank does not derive a speculative or underwriting profit, but only profits as a "fiduciary" (Citibank Br. 57-58).

Citibank in fact derives profit from its fund—one-half of 1 percent per annum on the net asset value of the fund (A. 152) and allocation of brokerage commissions (A. 153) —in exactly the same manner as do the sponsors of conventional mutual funds, which the Federal Reserve has long held to be subject to the Glass-Steagall Act (Pet. Br. 25-27, 29-30, 32 n.38).[20] We do not understand respondents to

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[19] The argument also misconstrues Section 16. The statutory phrase "for the account of customers", on which respondents rely, does not support their claim that Section 16 was intended to confer authority upon national bank trust departments to engage in portfolio activities. Section 16 is addressed to all national banks, not merely to those holding trust powers. It neither permits nor prohibits banks from engaging in such portfolio activities—whether in behalf of an individual trust account, an individual managing agency account, or for a collective fund. That authority derives from the banks' fiduciary permit. The limited purpose of the words "for the account of customers" was, as we have shown (Pet. Br. 28-29), to permit a national bank (whether or not authorized to act as a fiduciary) to purchase and sell securities as an accommodation service for regular bank customers. See Bull. of the Comptroller of the Currency, Oct. 26, 1936, ¶ 35 (not publicly circulated; on file in the Office of the Comptroller of the Currency, Treasury Department); Digest of Opinions of the Comptroller of the Currency Relating to Operations and Powers of National Banks ¶ 220 (April 1, 1960), 4 CCH FED. BANKING LAW ¶ 59,654.

[20] The argument in any event ignores the fact that there will be unique pressures on the bank to sell interests in its fund to protect the size of its advisory fees; hence, the fund runs afoul of Congress' aim to prevent bankers from having conflicts of interest in giving investment advice (see Pet. Br. 33-35). The small size of each "account" in Citibank's fund requires a large volume of business (A.

urge that these were wrongly decided by the Federal Reserve (see Citibank Br. 56-57).

Indeed, the record in this case contains a ruling by the Federal Reserve that the Glass-Steagall Act applies to a mutual fund which derives no direct profit from the sale of shares in the fund. In response to an inquiry from petitioner Investment Company Institute, the Board ruled that it was not

> "relevant that the stock is sold to the public through independent organizations with the result that the . . . [mutual fund] derives no direct profit from such sales.
>
> . . .
>
> "For the reasons indicated,[21] the Board continues to be of the opinion that the ordinary open-end investment

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195-96; see also *1963 Hearing supra* note 4, at 8). Further, customers continuously redeem their shares for cash. These factors jointly produce a pressure to sell customers on the virtues of the fund and avoid redemptions which are identical to the pressures on conventional mutual funds. On the other hand, when a trust officer decides to invest part of a trust's assets in the common fund or, conversely, to withdraw part of a trust's assets from the fund and to invest the proceeds elsewhere, the bank's overall income may not change since the size of the trust corpus against which its fee is determined may remain the same. Furthermore, even after the trust officer's withdrawal of a trust's assets from the common fund, the trust itself is still presumably as large and as worthwhile for the bank to administer as it was before. In contrast, a $10,000 managing agency account is too small for the bank to administer (A. 196, 268); hence, redemption of a customer's interest in the bank's mutual fund ends the customer's relation with the bank and reduces *pro tanto* the size of the corpus against which the bank's fee is calculated. Redemptions and new participations are also important because the economies of scale involved affect the fund's overall performance (Pet. Br. 34-35). All these factors necessarily lead to an emphasis upon securing new investors and avoiding redemptions which have no counterpart in other trust department activities, including common trust funds.

[21] The Board had noted earlier in its opinion that a mutual fund is engaged in the "issue" of securities within the meaning of the Glass-Steagall Act because:

company must be regarded as an organization of the kind described in section 32 of the Banking Act of 1933 [the Glass-Steagall Act]" (A. 172).

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In sum, then, respondents fail in their effort to bring the Citibank type of fund within some kind of "fiduciary" umbrella. The claim does not survive the fact that Citibank asks no more about the customer than his name, address and social security number. See note 5, *supra*. The savings of the 70-year old widow with no relatives and of the young businessman are automatically placed into a fund geared to "long-term growth of capital and of income" (A. 147). A common trust fund would have been unlawful if operated in the manner contemplated by the Citibank plan.

Even if Citibank had the information with which to make the kind of "suitability" determination that it claims to make, it would be doing no more than what SEC requires of brokers and dealers who sell shares in mutual funds. See note 5, *supra*. The essential features of the Citibank prototype plan—which include holding out of the commingled fund itself as an investment medium, automatic commingling, the right of redemption, daily valuations, the absence of investment discretion once the customer's money is taken, and the use of the fund to attract money seeking investment alone rather than to service existing "fiduciary" accounts—all lead to the conclusion that the bank is in sum and substance selling interests to the public in its funds. The "managing agency" contract is simply the legal device by which the bank sells shares in that fund, which is otherwise indistinguishable from a mutual fund. Therefore, Citibank's description of its plan as one in which

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"A mutual fund is, of course, engaged more or less continuously in the redemption of the stock issued by it and, consequently, it could not well carry on its activities if it did not issue its own stock on a virtually continuous basis" (A. 171-72).

> "a customer-investor desiring to use the Bank's fiduciary services entrusts it with a minimum of $10,000 under a broad authorization which includes specific authority for the bank to invest the customer's funds, together with the funds of other customers who have given the same authorization, through a Commingled Investment Account" (Citibank Br. 10-11)

translated means: "A share in Citibank's mutual fund costs $10,000."

III.

Respondents' policy arguments should be addressed to Congress not the courts.

Several arguments which respondents raise in defense of the Comptroller's approval of Citibank's fund urge in effect that the courts should as a matter of policy lift the barrier between the banking and securities industries, which is now of more than 30 years standing. Such arguments should be directed to Congress.

A. Respondents rely upon a letter from former Federal Reserve Chairman Martin to the Senate Committee on Banking and Currency, appended to Citibank's brief. The letter does not argue that the Glass-Steagall Act is inapplicable to the Citibank type of fund but rather presents policy arguments in support of legislation which would have in effect *amended* the Glass-Steagall Act so as to permit banks to engage in such activities. The thrust of Mr. Martin's position is that, on the basis of experience since 1933, particularly the effectiveness of federal banking and securities regulatory supervision, such funds do not now involve the dangers that Congress in 1933 saw in banks conducting securities activities. This is not the appropriate forum to debate these policy assertions.

This Court rejected analogous contentions in *Board of Governors* v. *Agnew*, 329 U.S. 441, 449 (1947). The Court held it immaterial that the facts showed no actual conflict of interest of the type the Glass-Steagall Act was designed to prevent. The relationship between securities and banking activities there involved was nonetheless barred because the purpose of the Act was "preventive" and "prophylactic."

B. Respondents also argue that as a matter of policy, the literal language of the Glass-Steagall Act should not be held applicable to funds of the Citibank type because the controls imposed by the Comptroller in Regulation 9 prevent the abuses which Congress had in mind in passing the Act (Citibank Br. 33, 57). Most banks, however, would not be subject to Regulation 9. Compliance by state banks with the Regulation is only necessary to secure the tax exemption afforded by *Internal Revenue Code of 1954* Section 584, but the same exemption can be achieved under *Internal Revenue Code of 1954* Section 851, by registering the fund under the Investment Company Act, as did Citibank.[22] Thus, a holding that Citibank's fund is not subject to the Glass-Steagall Act because of the controls imposed by Regulation 9 might require the courts to make a case-by-case appraisal of the nature of the regulatory controls imposed upon each state bank which seeks to organize such a fund.[23]

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[22] See Pet. Br. 7-8.

[23] There are further difficulties with reliance upon Regulation 9. The American Bankers Association has indicated that banks could be prevented from turning commingled managing agency accounts into a mutual fund if they were not permitted to accept investments of less than $10,000 or make portfolio valuations more frequently than once a month. Harris, *Trust Division Annual Report*, TRUST BULL., Oct. 1965, at 13, 18. Regulation 9 contains neither of these restrictions. The Regulation does not specify the minimum amount of participation. There is at least one

C. Respondents' reliance (and that of the court below—A. 266) on the supposed unanimity of views of the federal agencies involved as proof "that the public interest will be served" by permitting banks to operate mutual funds (Citibank Br. 27) has since misfired. The SEC now refuses to defend in this Court its earlier decision granting Citibank's application for Investment Company Act exemptions. The government says these exemptions are essential to the operation of such a fund under the banking laws (Brief for United States as Amicus Curiae at 3, 8-9, *National Ass'n of Securities Dealers* v. *S.E.C.*, U.S. Sup. Ct. No. 59, October Term, 1970). Quite apart from the extraordinary appearance of the United States as amicus to defend what may be described as the "ghost of SEC past," the significance of the situation is that the SEC seems to want a free hand to consider *de novo* the issues involved in the various bank applications for similar exemptions now pending before the agency. These are being held in abeyance pending the outcome of this proceeding (see Brief for Corporate Fiduciaries Association as Amicus Curiae at 4, this case).

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pending application by a state bank before the SEC which provides for a minimum of $1,000. Application for a 6(c) exemption by Security Trust Company, Rochester, New York, dated July 14, 1970, SEC File 812-7802. See also Compt. Br. 7 n.5. Nor does the regulation control the maximum frequency of valuations, which of course determines the ease with which entry into and withdrawal from the fund may be made. The regulation only covers the *minimum* frequency of valuations, which it sets at not less than once each three months. 12 C.F.R. § 9.18(b)(4) (1963, as amended). The Citibank prototype fund permits *daily* valuations (A. 148-49, 150-51).

IV.

Petitioners have standing to challenge the Comptroller's authority to permit banks to engage in the mutual fund business.

The Comptroller also argues that petitioners have no "standing" to challenge his authorization of bank entry into the mutual fund business.[24] Both the District Court (A. 225) and the Court of Appeals (A. 266) rejected this contention. In the Court of Appeals, Judge Bazelon found that the petitioners had standing; the "doubts" of the two remaining judges were "resolved in favor of reaching the merits in cases of this consequence" (A. 266) and they concurred in the result of Judge Bazelon's "opinion which holds that [petitioners] have standing" (A. 309).

This Court has, in a consistent course of recent decisions, liberalized the doctrine of standing, which had previously been applied to bar injured persons from challenging allegedly illegal governmental actions. See *Data Processing Service* v. *Camp,* 397 U.S. 150 (1970); *Barlow* v. *Collins,* 397 U.S. 159 (1970); *Flast* v. *Cohen,* 392 U.S. 83 (1968); *Hardin* v. *Kentucky Utilities Co.,* 390 U.S. 1 (1968). These decisions reflect the "trend . . . toward enlargement of the class of people who may protest administrative action." *Data Processing Service* v. *Camp,* 397 U.S. at 154. Recently, this Court expressly discarded the "legal interest" test as a condition of standing, which had long served as the basis for Government arguments to foreclose judicial review of allegedly unlawful Government action.[25]

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[24] The practical consequences of the Comptroller's position is that his conduct even if unlawful, is unreviewable, since petitioners are the only likely parties to challenge the validity of the Regulation.

[25] The Comptroller makes the curious argument that, although the *Data Processing* case discarded the "legal interest" test as a

Petitioners meet the prerequisites for standing set forth in the *Data Processing* case. *First,* the challenged actions of the Comptroller unquestionably will cause "injury in fact." 397 U.S. at 152. On the basis of undisputed facts, the District Court found that petitioners "would suffer serious and irreparable injury by reason of the establishment and operation of managing agency collective investment funds pursuant to provisions of 12 C.F.R. §9 . . ." (A. 256). The Comptroller has predicted that hundreds of banks might operate bank mutual funds, *1963 Hearing, supra* note 4, at 53, and that in the next decade commercial banks operating under the challenged regulations "might capture as much as two billion dollars of mutual fund business" (A. 218). Respondents have not challenged this showing of "injury in fact." [26]

Second, petitioners' prayer for the consistent application of the Glass-Steagall Act to maintain the established separation of commercial banking from the securities business cannot seriously be doubted to fall "arguably within the zone of interests to be protected or regulated by the

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prerequisite to standing, the same standard nevertheless should be resurrected as a condition to granting relief, even where a proper plaintiff with standing has demonstrated that a challenged governmental act is illegal and has caused him injury in fact. (Compt. Br. 21). This contention misinterprets a comment from the *Data Processing* case that "the 'legal interest' test goes to the merits." 397 U.S. at 153. Petitioners believe that statement merely reflected the well-recognized view that the application of the "legal interest" test had previously involved an analysis of the ultimate merits of the case in the determination whether a particular plaintiff had a "legally protected" interest, and thereby had standing to sue. See *Scanwell Laboratories, Inc.* v. *Shaffer,* 424 F.2d 859 (D.C. Cir. 1970); 3 DAVIS, ADMINISTRATIVE LAW 217 (1958).

[26] In the view of Justices Brennan and White, a showing of "injury in fact" is a sufficient basis to hold that petitioners have standing to sue. See *Barlow* v. *Collins,* 397 U.S. at 167, 168 (concurring opinion).

statute . . . in question." 397 U.S. at 153. As we have previously pointed out (Pet. Br. 11, 29), for more than 30 years the relationships between mutual funds and commercial banks have been restricted by the very sections of the Glass-Steagall Act at issue in this case. Section 32 of the Glass-Steagall Act, 12 U.S.C. § 78, has consistently been applied to prohibit any interlocking relationships between mutual funds and commercial banks. Mutual funds are required by law to have a certain number of unaffiliated directors on their boards of directors. Investment Company Act Section 10(a), 15 U.S.C. § 80a-10(a). A large pool of qualified persons who serve as bank directors have been barred from serving on the boards of mutual funds because, as the Federal Reserve Board has repeatedly held, this interlocking relationship constitutes a violation of Glass-Steagall. See 27 FED. RES. BULL. 399 (1941); 36 FED. RES. BULL. 645 (1951); A. 171; Citibank Br. 56 n.53. In affirming this position in its most recent ruling, the Board stated that it "continues to be of the opinion that the ordinary open-end investment company must be regarded as an organization of the kind described in Section 32 of the Banking Act of 1933" (A. 172).

Even more germane, however, is the fact that, as the Comptroller would be the first to assert, Section 21 of the Glass-Steagall Act, 12 U.S.C. § 378, prohibits an ordinary mutual fund from "engaging in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor," *i.e.*, the business of commercial banking. Accordingly, mutual funds are squarely within the zone of interests "regulated" by the

Glass-Steagall Act, within the meaning of this Court's decision in *Data Processing*.[27]

Since the issue here turns on a statute designed to sever—and keep separate—two distinct industries, the decision of this Court in *American Trucking Ass'ns* v. *United States*, 364 U.S. 1 (1960), is particularly apposite. There, certain motor carriers challenged the lawfulness of a grant by the ICC of operating authority to a subsidiary of a railroad which permitted it to offer motor carrier services. This Court's opinion reflected that "Congress has expressed a strong general policy against railroad invasion of the motor carrier field," 364 U.S. at 6, and found that plaintiffs had standing to challenge the Commission's violation of these Congressional policies which had the effect of creating new illegal competition.

Third, there can be no serious claim that "judicial review of the Comptroller's action has been precluded" under any relevant statute. *Data Processing Service* v. *Camp*, 397 U.S. at 156.[28] There are no provisions in the Glass-Steagall Act or in the other national banking laws which indicate that Congress intended to foreclose judicial re-

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[27] It is noteworthy that, in *Data Processing Service* v. *Camp*, in determining the "zone of interests" the Court did not refer to any legislative background of the Act because such a consideration would "implicate the merits" of the case. 397 U.S. at 156. In resolving this issue, the Court looked no further than the face of the two statutory provisions in question. It noted that neither act "in terms protect[s] a specific group." *Id.* at 157. The Court stated that, nevertheless, the "general policy is apparent; and those whose interests are directly affected by a broad or narrow interpretation of the Act are all easily identifiable." *Id.* This same analysis is equally applicable here.

[28] The Administrative Procedure Act provides that the judicial review provisions of that Act apply "except to the extent that—(1) statutes preclude judicial review; or (2) agency action is committed to agency discretion by law." 5 U.S.C. § 701, Supp. V, 1970.

view of the Comptroller's actions. The presumption favors judicial review, *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 140 (1967), and a variety of the Comptroller's decisions have been subject to judicial review.[29]

Indeed, Section 702 of the Administrative Procedure Act[30] provides an independent basis for judicial review for petitioners who are "adversely affected" and suffer "injury in fact" as a result of allegedly illegal agency action. See *Scanwell Laboratories, Inc.* v. *Shaffer*, 424 F.2d 859, 865, 870, 872 (D.C. Cir. 1970); Davis, *The Liberalized Law of Standing*, 37 U. CHI. L. REV. 450, 465-468 (1970); *cf. Data Processing Service* v. *Camp*, 397 U.S. at 157.

In sum, petitioners' suit is the only realistic means of reviewing the Comptroller's actions challenged here. The Glass-Steagall Act has separated commercial banking from the mutual fund business, and its prohibitions have been applied repeatedly to bar members of the mutual fund industry from expanding into commercial banking. The case arose in a context involving an actual collective investment fund created pursuant to an allegedly unlawful regulation of the Comptroller which would now permit commercial banks to expand into the mutual fund business. Under recognized criteria, there can be no doubt that petitioners have standing to challenge the Comptroller's regulations.

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[29] See Pet. Br. 7 n. 6.

[30] Section 702 provides: "A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof." 5 U.S.C. § 702, Supp. V, 1970.

CONCLUSION

The judgment of the Court of Appeals should be reversed and the cause should be remanded to that Court to enter judgment affirming the judgment of the District Court.

Respectfully submitted,

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